MANAGEMENT DISCUSSION SECTION

Peter I. Cittadini, Chief Executive Officer and President

Okay. Thank you and welcome everyone. We will try to be pretty efficient with this. So let me see – the format is 25 minutes of speaking and then Q&A in the same room here. Next door, okay. All right, well we will be efficient. Please notice the Safe Harbor statement and now I will get right into it.

Actuate Corporation, Silicon Valley based has quite a substantial footprint because of the customers that we sell to and service on a global basis. Those customers are 4,500 plus of top tier accounts primarily in the financial services sector defined as insurance, brokerage, banking, but obviously beyond that sector quite horizontal.

You get a full service shop when you do business with Actuate that being training, consulting, support and of course we have key substantial partners in Oracle, IBM and Eclipse, that help us on a global basis and primarily through technology.

When you look at what Actuate brings to bear, this is sort of the graphic of the technology stat that we bring to bear. And at the end of the – at the bottom of the pyramid it's really Actuate and its technology called BIRT. This is the new technology brought to the market by open source which means you can freely download it and it is a world class development environment where you could build any Actuate application you have a requirement for.

It also comes with an extremely large community of developers because our strategy is to get to 4 to 6 million developers over time. Today, we estimate we have about 750,000 developers. But a very, very large community to help our customers in building their applications, well, what do they build? They build either intranet oriented or extranet oriented applications with this technology stack. Typically intranet is more BI performance management or reporting oriented applications that are used to help you run your business more effectively.

On the extranet side, they're really customer facing applications like banking statements, credit card statements, and making them more modern Web 2.0 interactive applications to build satisfaction and loyalty ultimately to drive additional revenues for your customer base because of higher valued services, that you are keying up for them. And at the very top here you'll see ideas of intranet applications that we've enabled for people: sales force mobility, stimulus act; management applications, performance, KPI score-carding – things of that nature.

On the right most side, you'll see Wealth Management, Customer Self Service, Online Corporate Banking, et cetera as examples of extranet applications that have been done with the Actuate Technology and BIRT. And who we do them with – we really pick our spots, we're not a very big market share oriented vendor. We like to do business with large global financial services firms and go deep over many decades. We also have a big OEM business with companies like Oracle, IBM and others that sell applications and corporate Actuate as part of their offering.

So I would say, between those two verticals, financial services on average 50% of what we do, OEM 20% of what we do, the other 30% is quite horizontal. But again, we really seek out people that we can have multiple decades worth of business with – very important to us.

And a few years back, we decided to sort of morph our traditional enterprise software company to include a very serious element of Open Source, and the punch line is ultimately for us Open Source will dramatically lower the cost of sales and marketing and drive margins up to best of class.

Today, for a company our size, best of class is 16 to 21% operating margins, we did 21 last year. But at roughly double our size, approximately 250 million, we think that range because of the Open Source additive vector in doing business at Actuate as an enterprise software company that those operating margins at 250 million should be about 30 to 40% operating margins. So that's what we are after is best-in-class operating margins because of more profitable revenues coming in through Open Source. And the way it works is Phase I is pretty much behind us. We have the global expansion of BIRT developers. So Phase I is: BIRT developers have to love the product, want to work with it daily. That's clearly happening and we are seeing our statistics moving up into the right as far as adoption of the product. Today, we estimate as I said earlier, 750,000 developers on our way to multiple millions.

Phase II that we are currently focused on is revenue acceleration, is connecting the dots between those developers and the Actuate commercial products that can give them additional value when it comes to scale performance for liability, interactivity, archiving, things of that nature. And you will see us diligently work over the next couple of years to get that revenue acceleration happening because of all of this global seedling that is well on its way. It has inertia in and of itself. It's not stoppable. BIRT is a phenomenon.

And then finally, once we get to -- and in the midst of the revenue acceleration phase, what we'd seeing because of the warm leads from an Open Source strategy that we're not highly funded by marketing and since when they surface, they're warmer and thus not highly sales cost intensive, what you will see is best-in-class operating margins primarily due to that very large P&L expense item called sales and marketing coming down dramatically. And we think that will make this business model extremely relevant to our shareholders, our employees and our customers.

When we look at the BIRT business in Q1 and you look at BIRT Exchange, which is our portal, our Open Source portal for that product line, you will see that everything from a year-over-year standpoint has been up, whether it be average -- daily page views, monthly visitors, unique downloads they are all up into the right when you see the growth of that website year-over-year – 10, 16, and 18%.

And as you know, we also, as part of birt-exchange.com, have a marketplace which is another tab on birt-exchange.com where you can go freely download applications which give you a crystal clear picture at what a BIRT based application is like, and it opens up the world of possibilities, because I will tell you Actuate with BIRT can do things that other people have just not seen before in the world of delivering information.

So overall, in Q1 we did 3.8 million. The license line associated with that 3.8 million grew over 30% from a year ago and we did over 135 transactions within the confines of Q1 associated with the BIRT business. So again, all moving in the right direction.

Another BIRT investment that we made in February during Q1 is this BIRT onDemand. So what the essence of it is, is to have an onDemand platform so you can go to the marketplace and if you don't have a server, you can download the application from the marketplace directly into BIRT onDemand and start using it immediately. So now you get relevancy as to what all of the commercial products lend in value to the BIRT based application or the nair that you've created. And again, this has just worked incredibly in 60 days, 450 accounts. Look at some of the account logos that have signed up for this offering. It's really going to be quite good in getting the application's exposure. And at some point in the future maybe a real viable way for us to do low end business within our customer base in a pure platform onDemand way. But again, very excited to have seen this take off as quickly as quickly as it did.

The other thing we do to try to connect the dots with those developers that are out there that are freely downloading the product is hosting them at BIRT days if you will, where they get free trading and additional software. Almost a 1,000 people attended in 2009. We had 12 road shows in Q2. We had this number of road shows in Q1 reaching out to 364 people. And you'll see that some of the leading companies are now sort of engaging with us through the road shows. So the developers download, say hey pretty cool product, who creates this product, looks like Eclipse; there is someone Actuate that's involved as well. They look us up. They get invited to a road show and boom; we are doing business with Taleo as an OEM already paying us money after downloading BIRT and having done BIRT embedded into their applications.

Cisco, same thing, an Internet application associated with BI and reporting, associated with networks and routers that Cisco brings to bear to their clients also an OEM relationship, so again really substantial traction associated with the BIRT strategy.

As some of you may have heard in February, we acquired a company up into Toronto called Xenos. They do transformation from print streams to PDF primarily. And it's amazing how much print stream data is still out there. And we do a lot of statementing types of applications as well. So we said good business in and of itself, however, wouldn't it be cooler if the print stream could be captured by the BIRT iServer and converted to instead of static PDF very interactive BIRT, maybe a great way to do a first phase of your customer facing application.

So we are in the midst of integrating those two technologies right now and a new innovation that they've recently come up with that has to do with the PDF is take any print stream, convert it to PDF and make sure that it's universally accessible for the visually impaired. So instead of doing non visually-impaired PDFs and going back and scrambling when there is a requirement for one, two, 1,000, 10,000 within your firm we give people the ability to convert all PDF to be universally accessible by visually impaired and again you see who it's backed by CNIB, AFB and RNFIB. So a great innovation, that will be capitalized on as Actuate though it was in the Xenos product plan prior to acquisition, so really good stuff there.

A few things on the numbers, as far as the Q1 non-GAAP P&L. Q1 of 2010 non-GAAP revenues including the $1 million Xenos deferred revenue adjustment totaled 30.1 million, a year-over-year increase of 3%, license revenues totaled 9.6 million up 10% year-over-year.

Maintenance revenues totaled 19 million up 4% year-over-year. There are four components to maintenance revenues that will fluctuate from period-to-period. I will describe this in more detail in a couple of slides.

Our professional services revenues continue to drop at 30% year-over-year. But the decrease had a little effect on the operating margin. The reality is the more things become ubiquitous with open source, the less a requirement for professional services of Actuate Corporation.

The OpEx increased 1.2 million or 5% from a year ago. We spent 2.5 million or $0.04 per share on a compliance-related legal expense during the quarter. The largest portion of that legal expense was related to the Oracle losses. And although the matter is scheduled for trial in the summer, we anticipate that the litigation costs in Q2 will also remain high.

Non-GAAP operating income for Q1 was 4.8 million with the corresponding margin of 15.9% and non-GAAP EPS totaled $0.06 for the quarter, net of the $0.04 per share impact resulting from the higher litigation cost.

Moving on to year-over-year non-GAAP revenue by region. This chart shows the performance of North America as compared to international markets. Revenues for Q1 of 2010 in North America totaled 23.1 million, a 2% increase from Q1 of '09. International revenues grew strong at 6% year-over-year and totaled seven million for the quarter. License revenues in North America totaled 7.2 million in Q1, a 3% increase over the same period a year ago, for the same comparative periods international license revenues grew 33%.

Maintenance revenues in North America totaled 14.8, a 4% increase over Q1 of '09, while maintenance revenues in our international subs totaled 4.2 million, up 5% year-over-year. Pro-serve (sic) professional services in North America totaled 1.1 in North America and 400k in international, within Q1 both down for – from Q1 of '09, but with a de-minimis impact on overall operating margins.

Moving on to this slide here, it just gives you a more granular look at what the pieces of maintenance are, as you know a lot of people like to look at the health of the maintenance business, and here we put together bit of a risk spectrum for you, that's low risk on the right and higher risk – sorry, low risk on the left, higher risk on the right, and the deal is base line maintenance which is the largest part of maintenance we go after, is defined as maintenant contracts that are due in period. And to tell you the truth, it's the biggest piece, it's the lowest risk and it grew year-over-year in mid-single digits.

Next to that, is first year maintenance; first year maintenance is associated with taking in order for a license. As license sales go down, on a year, that means your first year maintenance will go down, because you're offering 20% of the lower number. And in '08 and in '09, we had down license years, thus down first year maintenance years accordingly.

License sales goes back up, this first year of maintenance goes back up. That maintenance is just a phenomenon of not being able to get to everyone very efficiently, so at times we'll three, four, six, maybe a year of slippage, as we're still rendering service in getting the purchase order or the contract completed. So at times you'll see lumpy back maintenance fall into a fiscal period, because all of the service has been rendered already and we've been trying to work out the details of the arranged bids.

And then finally, the highest risk as in the Oracle case. They've misused products and thus maintenance associated with that product and there'll be a large back-maintenance portion associated with that settlement in our opinion. However, it's very, very difficult for us to forecast to you when it will be completed, since it's heading to trial.

So again, lumpiness on the right hand side of the spectrum, which indeed could cause perceptions associated with our maintenance business. This is the core of our maintenance business. It's the biggest portion, it's low risk and it's up year-over-year. So we did want to make those comments, because we did get a fair amount of questions associated with the maintenance line during the course of Q1.

So moving on, we'll look at some other operating comments associated with Q1. Of course, the Q1 revenues did not include Xenos, that did not close until February 2, so it's only two months of recorded revenues. Orders over 100K, we did with 52 customers, that was down from 62 customers a year ago, but the average order size increased. We did two transactions with license components greater than $1 million. Income related, as I said before, non-GAAP operating margin was 15.9%. We did spend 2.5 million associated with litigation expense and that cost us a full $0.04 of fully diluted EPS. But we believe that it is in shareholders' best interest that we vigorously pursue this. And FX cost us $0.01 unfavorably.

Moving on, looking at the balance sheet, cash and investments totaled 68.2 million at the end of the quarter, a decrease of 7.3 million from 12/31/09. During the first quarter, we purchased Xenos for 27 million net of their cash, we used another 5 billion to repurchase Actuate stock on the market. Offsetting cash generations included 10 million in increased borrowings and 11 million plus of cash flow from operations.

You can see that the large positive cash flow from operation was driven by a significant reduction in accounts receivable. The 27 million increase in goodwill and purchase intangibles was attributable to Xenos' acquisition, and deferred revenue decreased 900k from 12/31/09, but was up 7% from the year ago.

Few other balance sheet comments, DSOs were at 59 days for the quarter down 39 days versus 12/31/09 based on non-GAAP revenue. 11.4 million cash flow from operations during the quarter, repurchased 5 million of Actuate stock during the quarter, and our employee count as of 3/31/10 was 572 employees. That was up 75 from a quarter ago and it did include 86 employees that were added to actuate cooperation as part of the Xenos transaction.

What you should expect from actuate on a going forward basis is double-digit growth in license revenues, double-digit percentage growth in BIRT-related business, maintenance revenue growth to continue to positive cash flow from operations and continued best-in-class non-GAAP operating margins, which we will define as 16 to 21%.

Longer purview, as I said, our end game with this new business model that has this serious dose of open source in it, it's to really get to 30 to 40% operating margins. That's roughly twice our size, would be approximately 250 million of top line revenues. And we're working diligently to get there.

Last year, our revenues were slightly higher than 119 million and we did 21% operating margins. That shows you that the possibilities behind BIRT and I think we did about 18.4 million with BIRT revenue there. That BIRT extremely, extremely profitable. So as we convert more of the legacy revenue to BIRT revenue, the 30 to 40% operating margins is extremely doable and I think exciting for us all.

And that's a wrap, and I guess we'll move next door for Q&A.